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Statement of Treasury Secretary John W. Snow on the Report on International Economic and Exchange Rate Policies

I am pleased to release today Treasury's latest Report on International Economic and Exchange Rate Policies and to share our thinking on the main highlights and conclusions.

Let me state at the outset: A strong dollar is in our nation's interest, and currency values should be determined in open and competitive markets in response to underlying economic fundamentals.

The international economy is performing exceptionally well. Global growth this year will exceed 4 percent for the fourth consecutive year. Inflation remains low and global financial conditions are benign. This is the best global performance in three decades. It is all the more impressive considering the serious disturbances faced only several years ago and the sharp run-up in oil prices.

The robust U.S. economy is strongly contributing to the favorable performance. First quarter growth this year was 4.8 percent at a seasonally adjusted annual rate, bouncing back strongly from the lower fourth quarter result last year. Growth over the last four quarters was 3.5 percent, the best of any major industrialized economy. The labor market has strengthened with 32 straight months of job growth, totaling more than 5.2 million new jobs since the President's tax relief took effect in May 2003. Inflationary pressures remain well contained -- consumer price inflation is running at 3.4 percent, but stripping out energy and food costs, core consumer price growth is only 2.1 percent over the past twelve months.

Key to the economic success of the United States is its openness. The United States must resist the forces of protectionism and isolationism. Foreign direct investment flows into the United States grew almost 60 percent in 2004 and more than 20 percent last year. Foreign direct investment generates a significant number of jobs – more than 5 million as of 2004.

Global imbalances are a key issue on the international economic agenda. They arise because of large growth disparities in major countries, differences in the relative attractiveness of investment in their economies, and divergent patterns of saving and investment. The U.S. current account deficit and corresponding surpluses elsewhere reflect these disparities. Reducing global imbalances, in an orderly manner that sustains and maximizes global growth, is a shared responsibility requiring complementary actions by a large number of countries. In this context, I have repeatedly emphasized that the international economy performs best when large economies embrace free trade, the free flow of capital and flexible currencies.

The international community has an agreed strategy to reduce global imbalances. The United States is working to raise national saving by cutting the fiscal deficit and increasing private saving. Our policies to do so are working. To help boost personal saving, the President has proposed expanding tax-free savings opportunities and simplifying our current confusing system. He has proposed replacing current-law IRAs with Lifetime Savings Accounts and Retirement Savings Accounts, consolidating employer-based retirement savings accounts, and establishing Individual Retirement Accounts for lower-income households for the purposes of education, home purchase, and business start-ups. And the 2005 deficit was within the 40-year historical norm as a percentage of GDP. The Administration remains committed to cutting the fiscal deficit and meeting the President's goal of halving the deficit by 2009, when it is projected to be well below that goal at about 1.4 percent of GDP. Last year tax revenues increased by almost 15 percent and they continue to grow by double digit percentages again this year. In fact, last week a Congressional Budget Office report said that the 2006 deficit is expected to be significantly less than originally anticipated due to the surge in federal tax receipts. It is in the U.S. national interest to continue pursuing the path of fiscal consolidation, but one should not overestimate the impact fiscal consolidation will have in reducing global imbalances. Let me also underscore that the United States does not have a current account target. Our aim is to achieve continued good, low-inflationary growth.

Europe and Japan need to promote structural reforms to strengthen potential growth. Growth in the Euro-area is witnessing a modest cyclical pick-up this year, but there is much more to be done. The Euro-area's overall external position is in near balance, but I reject the view that Europe thus has little role to play in the global adjustment process. After struggling for many years, Japan's economy appears to have turned the corner. Corporate and banking sector restructuring have been largely completed, leading to rising full-time employment, investment and bank lending. As Japan emerges from deflation, a broad structural reform agenda is needed to raise productivity growth, promote sustained domestic demand-led growth, and lessen the economy's reliance on export-led growth.

Rising oil prices are also affecting global imbalances. In the last three years, oil revenues for the largest oil exporters have grown by $410 billion. These countries can contribute to the adjustment process through accelerated investment in capacity and increased diversification.

Let me turn to emerging Asia, and China specifically. Strong growth in China and the region have helped propel the global economy. But greater exchange rate flexibility in emerging Asia is an irreplaceable component of the adjustment of global imbalances, and Chinese exchange rate flexibility is the lynchpin of currency flexibility in emerging Asia.

China's international economic and exchange rate policies are deeply concerning. The United States has been joined by the international community, including the G-7, the IMF, and Asian Development Bank, in vigorously encouraging China to implement greater exchange rate flexibility. In the final analysis, though, the Treasury Department is unable to conclude that China's intent has been to manage its exchange rate regime for the purposes of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade. Thus, we have not designated China pursuant to the 1988 Trade Act. Let me share with you our reasons.

China is engaged in an historic transformation to a market system. To achieve the requisite economic rebalancing, China must make its currency regime more flexible, strengthen consumption and modernize its financial system – the three pillars of our policy engagement.

China's leadership has publicly committed to take these steps. President Hu, in a meeting with President Bush on April 20, stated that China does not want a large current account surplus and will act to reduce it. Premier Wen made this same commitment in his speech to the National People's Congress and also committed to allow more exchange rate flexibility. China's recent five-year plan places strong emphasis on consumption and rural development in order to spur domestic demand. China's Central Bank Governor laid out a five-point plan to reduce the surplus, including efforts to boost domestic demand, reduce China's high saving rate, accelerate removal of trade barriers, allow foreign firms greater access and achieve greater exchange rate flexibility.

Of course, words must be backed by action, and China is taking some action. On the exchange rate front, China abandoned its eight-year peg against the dollar last July, and the renminbi (RMB) has moved slightly higher against the dollar since that time. But given the close relationship between the RMB and the dollar and because the dollar appreciated last year across the board, China's currency on a trade-weighted basis appreciated by over 9 percent last year. China has also taken steps to create a deeper and more liquid foreign exchange market, allowing interbank foreign currency trading for the first time this year.

China is also acting to boost consumption, dampen its high saving rate, and promote domestic demand. Recently, China has put in place steps to cut taxes, develop rural areas, and raise minimum wages.

China's efforts to modernize its weak financial sector are part of the strategy to spur consumption and more efficient investment. In the last year and a half, China has acted to tighten its risk classification system for bank loans, deregulate and raise bank lending rates, and bring in foreign expertise and know-how to improve the soundness and market-orientation of the banking system. We strongly urge China to allow foreign firms greater access to China's financial system and to lift the ownership caps facing foreign entities.

Let us be clear: we are extremely dissatisfied with the slow and disappointing pace of reform of the Chinese exchange rate regime. The RMB's appreciation has done little to curb China's large current account surplus or cool its fast-growing economy, which last quarter was at an over 10 percent annual rate. Further exchange rate flexibility is a key tool for tightening financial conditions amid ample liquidity, reinforcing the effect of recent monetary policy actions aimed at cooling economic activity. Thus, this slow pace is neither in China's self-interest nor in the interest of the world economy. With a still rigid exchange rate, China lacks effective monetary policy tools to avoid the boom-bust cycles it has experienced in the past. This is particularly important now that investment in China appears to be reaccelerating, increasing the risk of a hard landing.

For the last three years, the Treasury Department has made engagement with China one of its top priorities. This intensive engagement has first and foremost concentrated on exchange rate flexibility, but also on the other steps necessary to shift the sources of growth toward domestic demand and consumption, reform the financial sector and to build the foreign exchange market infrastructure. While the economic face of China changes rapidly each day, we are not satisfied with the progress made on China's exchange rate regime and we will monitor closely China's progress every step of the way.

It is important for China to understand that its exchange rate regime is not simply a bilateral US-China issue, but a multilateral issue. Chinese exchange rate practices affect the entire world. The IMF is the world's only multilateral institution with a mandate to consider exchange rates. Managing Director Rodrigo De Rato has called for strengthening IMF exchange rate surveillance in his medium-term strategy. Further, at the recent IMF/World Bank spring meetings, he developed a new mechanism for multilateral consultations to broaden the global discussion of imbalances. The IMF must take this mandate for leadership by encouraging real reform in the Chinese currency regime.

In conclusion, the entire international community must work together cooperatively to address global imbalances, but it is a matter of extreme urgency that China act immediately to increase the flexibility of its exchange rate regime before real harm is done to its own economy, to its Asian neighbors, and to the global financial system.